

FINANCIAL AUDIT  
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT  
OF THE  
DEPARTMENT OF ENVIRONMENTAL QUALITY

October 1, 1999 through September 30, 2001



Michigan  
*Office of the Auditor General*  
**REPORT SUMMARY**

**Financial Audit**

Report Number:  
 76-100-02

*Including the Provisions of the Single Audit Act  
 October 1, 1999 through September 30, 2001*

**Department of Environmental Quality (DEQ)**

Released:  
 June 2002

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with State compliance requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

**Financial Statements and Financial Schedules:**

**Auditor's Reports Issued**

We issued unqualified opinions on DEQ's financial statements and financial schedules.

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**Internal Control Over Financial Reporting**  
 We did not report any findings related to internal control over financial reporting.

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**Noncompliance Material to the Financial Statements and Financial Schedules**  
 We did not identify any instances of noncompliance applicable to the financial statements and financial schedules that are required to be reported under *Government Auditing Standards*.

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**Federal Awards:**

**Auditor's Reports Issued on Compliance**

We audited 9 programs as major programs and issued 7 unqualified opinions and 2 qualified opinions. The types of opinions issued by federal program are identified on the back of this summary.

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**Internal Control Over Major Programs**  
 We did not report any findings related to internal control over major programs.

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**Required Reporting of Noncompliance**  
 We identified an instance of noncompliance that is required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133 (Finding 1).

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**Systems of Accounting and Internal Control:**

We determined that DEQ was in substantial compliance with Sections

18.1483 - 18.1487 of the *Michigan Compiled Laws*.

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We audited the following programs as major programs:

<u>CFDA Number</u>	<u>Program Title</u>	<u>Compliance Opinion</u>
11.419	Coastal Zone Management Administration Awards	Unqualified
66.001	Air Pollution Control Program Support	Unqualified
66.419	Water Pollution Control - State and Interstate Program Support	Unqualified
66.432	State Public Water System Supervision	Unqualified
66.458	Capitalization Grants for State Revolving Funds	Qualified
66.460	Nonpoint Source Implementation Grants	Unqualified
66.468	Capitalization Grants for Drinking Water State Revolving Fund	Qualified
66.801	Hazardous Waste Management State Program Support	Unqualified
66.802	Superfund State Site - Specific Cooperative Agreements	Unqualified

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: [www.state.mi.us/audgen/](http://www.state.mi.us/audgen/)



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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

June 28, 2002

Mr. Russell J. Harding, Director  
Department of Environmental Quality  
Constitution Hall  
Lansing, Michigan

Dear Mr. Harding:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Department of Environmental Quality (DEQ) for the period October 1, 1999 through September 30, 2001.

This report contains our report summary; our independent auditor's reports on the financial statements and on the financial schedules; and the DEQ financial statements and financial schedules, notes to the financial statements and financial schedules, and supplemental financial statements and financial schedules. This report also contains our independent auditor's reports on compliance and on internal control over financial reporting and on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133 and our schedule of findings and questioned costs. In addition, this report contains DEQ's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our finding and recommendation are contained in Section III of the schedule of findings and questioned costs. The agency preliminary response is contained in the corrective action plan. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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# TABLE OF CONTENTS

## DEPARTMENT OF ENVIRONMENTAL QUALITY

### INTRODUCTION

	<u>Page</u>
Report Summary	1
Report Letter	3

### INDEPENDENT AUDITOR'S REPORTS, FINANCIAL STATEMENTS, AND FINANCIAL SCHEDULES

Independent Auditor's Report on the Financial Statements	8
Independent Auditor's Report on the Financial Schedules	10
Department of Environmental Quality Financial Statements and Financial Schedules	
Combined Balance Sheet	12
Combined Statement of Revenues, Expenditures, and Changes in Fund Balance	13
Schedule of General Fund Revenues and Transfers	14
Schedule of Sources and Disposition of General Fund Authorizations	15
Notes to the Financial Statements and Financial Schedules	16

### SUPPLEMENTAL FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES

Special Revenue Funds	
Descriptions	24
Combining Balance Sheet	26
Combining Statement of Revenues, Expenditures, and Changes in Fund Balance	27

Balance Sheet - Combined Environmental Protection Bond Fund	28
Statement of Revenues, Expenditures, and Changes in Fund Balances - Combined Environmental Protection Bond Fund	29
Agency Fund	
Description	30
Statement of Changes in Assets and Liabilities - Environmental Quality Deposits Fund, Fiscal Year Ended September 30, 2001	31
Statement of Changes in Assets and Liabilities - Environmental Quality Deposits Fund, Fiscal Year Ended September 30, 2000	32
Schedule of Expenditures of Federal Awards	34

#### INDEPENDENT AUDITOR'S REPORTS ON COMPLIANCE AND INTERNAL CONTROL

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting	39
Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	41

#### SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I: Summary of Auditor's Results	43
Section II: Findings Related to the Financial Statements and Financial Schedules	45
Section III: Findings and Questioned Costs Related to Federal Awards	45
1. State Revolving Fund (SRF) Program Subrecipient Designation	45

#### OTHER SCHEDULES

Summary Schedule of Prior Audit Findings	50
Corrective Action Plan	55

## GLOSSARY

Glossary of Acronyms and Terms

56





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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on the Financial Statements

April 24, 2002

Mr. Russell J. Harding, Director  
Department of Environmental Quality  
Constitution Hall  
Lansing, Michigan

Dear Mr. Harding:

We have audited the accompanying combined balance sheet of the Department of Environmental Quality as of September 30, 2001 and September 30, 2000 and the related combined statement of revenues, expenditures, and changes in fund balances for the fiscal years then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1d, the accompanying financial statements present only specific funds administered by the Department of Environmental Quality and are not intended to present fairly the financial position and results of operations of the Department, the State of Michigan, or the State's special revenue and agency funds.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Department of Environmental Quality's

funds, as listed in Note 1a, as of September 30, 2001 and September 30, 2000 and the results of operations for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 24, 2002 on our tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying supplemental financial statements, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

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## Independent Auditor's Report on the Financial Schedules

April 24, 2002

Mr. Russell J. Harding, Director  
Department of Environmental Quality  
Constitution Hall  
Lansing, Michigan

Dear Mr. Harding:

We have audited the accompanying schedule of General Fund revenues and transfers and the schedule of sources and disposition of General Fund authorizations of the Department of Environmental Quality for the fiscal years ended September 30, 2001 and September 30, 2000. These financial schedules are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial schedules based on our audit. The governmental operations of the Department are accounted for principally in the General Fund of the State of Michigan.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1d, the accompanying financial schedules include only the revenues and transfers and the sources and disposition of authorizations for the Department of Environmental Quality's General Fund accounts, presented on the modified accrual basis of accounting. Accordingly, these financial schedules are not intended to constitute a complete financial presentation of either the Department or the

State's General Fund in accordance with accounting principles generally accepted in the United States of America.

In our opinion, the financial schedules referred to in the first paragraph present fairly, in all material respects, the revenues and transfers and the sources and disposition of authorizations of the Department of Environmental Quality for the fiscal years ended September 30, 2001 and September 30, 2000, on the basis of accounting described in Note 1c.

As disclosed in Note 2, the State of Michigan adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. The Statement required that many items previously reported as equity transfers be reported as expenditures.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 24, 2002 on our tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and other supplemental financial schedules, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the Department's financial schedules referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial schedules and, in our opinion, is fairly stated, in all material respects, in relation to the financial schedules taken as a whole.

AUDITOR GENERAL

DEPARTMENT OF ENVIRONMENTAL QUALITY  
 Combined Balance Sheet  
As of September 30  
 (in thousands)

	<u>Governmental Fund Types</u>		<u>Fiduciary Fund Types</u>	
	<u>Special Revenue</u>		<u>Agency</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
<b>ASSETS</b>				
Current Assets:				
Cash	\$ 37	\$	\$	\$
Equity in Common Cash	201,620	189,672	3,407	2,440
Taxes, interest, and penalties receivable	5,693	5,110		
Amounts due from local units	1,286	1,891		
Amounts due from other funds	1,000			
Other current assets	4,755	4,909		
Total Current Assets	<u>\$ 214,392</u>	<u>\$ 201,582</u>	<u>\$ 3,407</u>	<u>\$ 2,440</u>
Amounts due from local units	4,467	3,785		
Other noncurrent assets	674	962		
Total Assets	<u>\$ 219,533</u>	<u>\$ 206,328</u>	<u>\$ 3,407</u>	<u>\$ 2,440</u>
<b>LIABILITIES AND FUND BALANCES</b>				
Current Liabilities:				
Warrants outstanding	\$ 809	\$ 2,607	\$	\$
Accounts payable and other liabilities	50,788	38,082	3,407	2,440
Amounts due to other funds	50	21		
Deferred revenue	318	336		
Total Current Liabilities	<u>\$ 51,966</u>	<u>\$ 41,047</u>	<u>\$ 3,407</u>	<u>\$ 2,440</u>
Deferred revenue	674	957		
Total Liabilities	<u>\$ 52,640</u>	<u>\$ 42,003</u>	<u>\$ 3,407</u>	<u>\$ 2,440</u>
Fund Balances:				
Reserves for:				
Budgetary carry-forwards:				
Encumbrances	\$ 4,326	\$ 4,883	\$	\$
Restricted revenues	115,262	86,474		
Multi-year projects	52,732	56,681		
Revolving loan programs	5,456	4,944		
Funds held as permanent investments (Note 8)	13,228	9,315		
Noncurrent assets		5		
Total Reserved	<u>\$ 191,005</u>	<u>\$ 162,301</u>	<u>\$ 0</u>	<u>\$ 0</u>
Unreserved	(24,112)	2,023		
Total Fund Balances	<u>\$ 166,893</u>	<u>\$ 164,325</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Liabilities and Fund Balances	<u>\$ 219,533</u>	<u>\$ 206,328</u>	<u>\$ 3,407</u>	<u>\$ 2,440</u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF ENVIRONMENTAL QUALITY  
 Combined Statement of Revenues, Expenditures, and Changes in Fund Balances  
Fiscal Years Ended September 30  
 (in thousands)

	<u>Governmental Fund Types</u>	
	<u>Special Revenue</u>	
	<u>2001</u>	<u>2000</u>
<b>REVENUES</b>		
Taxes	\$ 58,495	\$ 59,820
Interest and other miscellaneous	45,575	39,130
Total Revenues	<u>\$ 104,069</u>	<u>\$ 98,950</u>
<b>EXPENDITURES</b>		
Current:		
General government	\$ 477	\$ 727
Health services	1,391	534
Environmental	105,458	76,050
Total Expenditures	<u>\$ 107,327</u>	<u>\$ 77,311</u>
Excess of Revenues Over (Under) Expenditures	<u>\$ (3,258)</u>	<u>\$ 21,639</u>
<b>OTHER FINANCING SOURCES (USES)</b>		
Proceeds from bond issues	\$ 60,499	\$ 81,947
Transfers from other funds	20,602	11,031
Transfers to other funds	(75,276)	(65,440)
Total Other Financing Sources (Uses)	<u>\$ 5,826</u>	<u>\$ 27,538</u>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	\$ 2,568	\$ 49,177
Fund Balances - Beginning of fiscal year	<u>164,325</u>	<u>115,147</u>
Fund Balances - End of fiscal year	<u>\$ 166,893</u>	<u>\$ 164,325</u>

The accompanying notes are an integral part of the financial statements.

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Schedule of General Fund Revenues and Transfers  
Fiscal Years Ended September 30  
(in thousands)

	<u>2001</u>	<u>2000</u>
<b>REVENUES</b>		
Taxes	\$ 1,664	\$ 1,253
From federal agencies	38,613	36,991
From licenses and permits	19,430	20,863
Miscellaneous:		
Section 29 (Note 9)	30,226	
Gas and oil privilege fees	13,396	6,418
Other sources	<u>24,556</u>	<u>19,385</u>
Total Revenues	<u>\$ 127,885</u>	<u>\$ 84,910</u>
<b>TRANSFERS</b>		
From Michigan Transportation Fund	<u>\$ 931</u>	<u>\$ 813</u>
Total Transfers	<u>\$ 931</u>	<u>\$ 813</u>
Total Revenues and Transfers	<u><u>\$ 128,816</u></u>	<u><u>\$ 85,723</u></u>

The accompanying notes are an integral part of the financial schedules.

**DEPARTMENT OF ENVIRONMENTAL QUALITY**  
Schedule of Sources and Disposition of General Fund Authorizations  
Fiscal Years Ended September 30  
(in thousands)

	<u>2001</u>	<u>2000 (RESTATED)</u>
<b>SOURCES OF AUTHORIZATIONS</b>		
General purpose appropriations (Note 2)	\$ 99,407	\$ 96,296
Balances carried forward	90,485	90,564
Restricted financing sources	137,220	91,661
Less: Intrafund expenditure reimbursements	<u>(14,576)</u>	<u>(10,616)</u>
Total	<u>\$ 312,535</u>	<u>\$ 267,905</u>
<b>DISPOSITION OF AUTHORIZATIONS</b>		
Gross expenditures and transfers (Note 2)	\$ 191,170	\$ 186,506
Less: Intrafund expenditure reimbursements	<u>(14,576)</u>	<u>(10,616)</u>
Net expenditures and transfers	<u>\$ 176,594</u>	<u>\$ 175,890</u>
Balances carried forward:		
Multi-year projects	\$ 21,165	\$ 23,956
Encumbrances	19,555	12,442
Restricted revenue (Note 7)	90,132	49,087
Revolving loan programs	<u>5,000</u>	<u>5,000</u>
Total balances carried forward	<u>\$ 135,852</u>	<u>\$ 90,485</u>
Balances lapsed	<u>\$ 89</u>	<u>\$ 1,530</u>
Total	<u>\$ 312,535</u>	<u>\$ 267,905</u>

The accompanying notes are an integral part of the financial schedules.



## Notes to the Financial Statements and Financial Schedules

### Note 1 Significant Accounting Policies

#### a. Reporting Entity - Financial Statements

The accompanying financial statements report the financial position and results of operations of the following funds administered by the Department of Environmental Quality (DEQ) as of and for the fiscal years ended September 30, 2001 and September 30, 2000:

##### Special Revenue

Combined Environmental Protection Bond Fund (includes the Environmental Protection Bond Fund and the Clean Michigan Initiative Bond Fund)

Michigan Underground Storage Tank Financial Assurance Fund

Bottle Deposits Fund

##### Agency

Environmental Quality Deposits Fund

These funds are a part of the State of Michigan reporting entity and are reported on in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

#### b. Reporting Entity - Financial Schedules

The accompanying financial schedules report the results of the governmental operations of DEQ for the fiscal years ended September 30, 2001 and September 30, 2000. The governmental operations of DEQ are accounted for principally in the State's General Fund and are reported on in the *SOMCAFR*. Other DEQ activities related to environmental clean-up are reported in various special revenue funds.

#### c. Basis of Accounting

The financial statements and financial schedules contained in this report are prepared on the modified accrual basis of accounting. The modified accrual basis of accounting, which emphasizes the measurement of

current financial resource flows, is explained in more detail in the *SOMCAFR*.

d. Basis of Presentation

The accompanying financial statements present only the funds listed in Note 1a. The accompanying financial schedules include only the revenues and transfers and the sources and disposition of authorizations for DEQ's General Fund accounts. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies; Budgeting, Budgetary Control, and Legal Compliance; Treasurer's Common Cash; Pension Benefits and Other Postemployment Benefits; Compensated Absences; and Interfund Receivables and Payables.

Accordingly, these financial statements and financial schedules are not intended to present fairly the financial position and results of operations or to constitute a complete financial presentation of DEQ, the State of Michigan, the State's General Fund, or the State's special revenue and agency funds in accordance with accounting principles generally accepted in the United States of America.

The financial transactions of DEQ are recorded in the General Fund and individual funds in the State's central accounting system. The various environmental quality funds are combined in the *SOMCAFR* into fund types described as follows:

Governmental Fund Types

Special Revenue Funds: This fund group includes operating fund activities financed by specific revenue sources that are legally restricted for specified purposes.

Fiduciary Fund Types

Agency Funds: This group includes assets held by DEQ on behalf of outside parties. DEQ's responsibility is custodial in nature, and the asset and liability balances, but not operating results, are included within these statements.

Note 2 Accounting Changes and Restatements

The State of Michigan implemented Governmental Accounting Standards Board (GASB) Statement No. 34, as amended by Statement No. 37, for the fiscal year ended September 30, 2001. This Statement's requirements represent a significant change in the financial reporting model used by state governments, including statement formats and changes in fund types and account groups. As a result, bonds and claims outstanding previously reported in the State's general long-term obligations account group are now reflected in the government-wide statement of net assets. Related amounts for the fiscal year ended September 30, 2000 reported in Note 4 have been restated.

Also, GASB Statement No. 34 requires that many items previously reported as equity transfers be reported as expenditures. In the fiscal year ended September 30, 2000, DEQ recorded an equity transfer of \$17.4 million from the General Fund to the Michigan Municipal Bond Authority (a discretely presented component unit) to provide federal matching funds and capital for the State Revolving Fund. The schedule of sources and disposition of General Fund authorizations for the fiscal year ended September 30, 2000 has been restated to reflect the new reporting requirement. As a result, gross expenditures and general purpose appropriations increased by \$17.4 million in fiscal year 1999-2000.

Further, components of the reserve of fund balance for the Bottle Deposits Fund were restated for the fiscal year ended September 30, 2000 to be consistent with the GASB Statement No. 34 reporting model and to improve consistency between State departments in recording reserves for revolving loan funds. Total reserved fund balance was unchanged. However, the permanent investment reserve increased by \$4.5 million, the noncurrent asset reserve decreased by \$3.8 million, the revolving loan program reserve increased by \$3.8 million, and the restricted revenue reserve decreased by \$4.5 million.

The preceding restatements result in a variation from the presentation in *SOMCAFR* for the fiscal year ended September 30, 2000. Approval for the restatement was granted by the Office of Financial Management, Department of Management and Budget.

Note 3 Joint Venture

The State, represented by DEQ, is a participant in a joint venture known as the Great Lakes Protection Fund. The joint venture is not reflected within this report because it did not meet generally accepted accounting principles' criteria for inclusion. A description of the joint venture follows. Complete financial statements may be obtained directly by contacting the Financial Reporting Section, Office of Financial Management, Department of Management and Budget, at (517) 373-3029.

The Great Lakes Protection Fund is a not-for-profit corporation located in Chicago, Illinois. Its purpose is to finance and support research with respect to water quality of the Great Lakes. The eight states bordering on the Great Lakes are eligible to become members if they make a required contribution to the endowment of the Fund. Contribution requirements were established based upon water consumption and usage. Michigan is the largest contributor to the Fund, having made a contribution of \$25 million, constituting approximately 31% of the total. Michigan made its required contribution in fiscal year 1989-90 by issuing the Fund a general obligation bond authorized as part of the State's environmental protection bond program. No additional contributions from Michigan will be required.

Each of the participating seven member states is represented by two members on the Fund's Board of Directors. The Board members are selected by the states' respective governors. The Fund's financing and budgeting operations are controlled by the directors within requirements established by the Articles of Incorporation. Net earnings after operating expenses are divided into parts. One-third of the net earnings on total contributions is granted to the respective states in proportion to their contributions to the Fund, to be used for the purposes of the Fund. Two-thirds of the net earnings are available to the Fund to make other grants. The State's equity interest in the Great Lakes Protection Fund of \$25 million is reflected in the *SOMCAFR* in the government-wide statement of net assets.

Note 4 MUSTFA Obligations

The special revenue fund named the Michigan Underground Storage Tank Financial Assurance (MUSTFA) Fund that is included in this report is not a full presentation of all activities related to the MUSTFA Program. The MUSTFA Finance Authority was established to provide financing, including short- and

long-term debt instruments, for the MUSTFA Fund. The Finance Authority's activities are recorded in another special revenue fund and a debt service fund both named Michigan Underground Storage Tank Financial Assurance Finance Authority. Other MUSTFA Program obligations are recorded as long-term obligations on the government-wide statement of net assets. These additional funds and statements are a part of the State of Michigan reporting entity and are reported on in the *SOMCAFR*.

Other MUSTFA Program financial activities are reported elsewhere as follows (in millions):

	Fiscal Year	
	2000-01	1999-2000 (RESTATED)
Obligations:		
Government-wide statement of net assets:		
Bonds outstanding	\$ 152.5	\$ 166.9
Claims outstanding	.2	1.8
Special revenue fund:		
MUSTFA Finance Authority		.2
Debt service fund:		
MUSTFA Finance Authority	(91.8)	(58.2)
	<u>        </u>	<u>        </u>
Net Obligations	<u>\$ 60.9</u>	<u>\$ 110.7</u>

Also see Note 6 and Note 9.

**Note 5 Federal Revenues and Expenditures**

Federal revenues in the schedule of General Fund revenues and transfers vary from the expenditures reported in the schedule of expenditures of federal awards. The schedule of expenditures of federal awards includes payments made by the Michigan Municipal Bond Authority to subrecipients in the State Revolving Fund and the Drinking Water State Revolving Fund. These expenditures and related federal revenues are not recorded in DEQ's appropriations.

Note 6 Fund Balance Deficits

The MUSTFA Fund, a special revenue fund, had an unreserved fund deficit of \$35.4 million at September 30, 2001. The deficit was caused by appropriations that exceeded revenue to date.

Note 7 Restricted Revenue

This revenue is restricted, by statute, for use to a particular department program or activity. However, the expenditure of the restricted revenue is subject to annual legislative appropriation.

Note 8 Funds Held as Permanent Investments

Funds held as permanent investments represent amounts that have been legally restricted for the purpose of providing a long-term source of investment income. These investments can include either specific investments held for the fund or portions of the fund's share of the Common Cash pool.

Note 9 Contingencies and Litigation

MUSTFA

The MUSTFA Fund, a special revenue fund, receives revenue dedicated to reimbursing owners/operators of underground storage tanks for costs incurred related to conducting corrective actions at sites where a release has occurred from an underground storage tank. The MUSTFA Fund was declared insolvent and received no additional claims after June 29, 1995. The revenue is still collected to pay off two main obligations of the MUSTFA Fund: the long-term liability for incurred claims recorded in the government-wide statement of net assets and the debt and the debt service charges associated with the financial borrowing mechanisms utilized to expedite reimbursement to eligible owners/operators, which is discussed in Note 4.

K & K Construction, Inc.

The State accrues liabilities in the government-wide financial statements for significant legal proceedings if a loss is probable and reasonably estimable. For the fiscal year ended September 30, 2001, \$15 million was recorded in the government-wide financial statements for litigation brought against DEQ by K & K Construction, Inc., in a land use/takings issue under the Wetlands Management Act. The \$15 million has not been recorded as a liability in DEQ's financial statements because the litigation has not been settled. The original court decision was against DEQ for \$3.7 million plus interest. However, the

Michigan Supreme Court vacated the judgment and remanded for redetermination of whether a taking occurred. DEQ believes that it will prevail at the appellate level.

#### Section 29 Tax Credit Revenues

On April 18, 2001, the Michigan Supreme Court affirmed the December 10, 1999 decision by the Court of Appeals, which upheld the constitutionality of Acts 133 and 134, P.A. 1996. The Acts authorized the State to sell the economic share of royalty interest it held in natural gas produced from Antrim formations qualifying for the federal tax credit in Section 29 of the *Internal Revenue Code*. The statute also provides that the net proceeds of the sale allocable to the tax credit shall be credited to the Environmental Protection Fund, which is administered by DEQ.

Tax credit revenues were accumulated in escrow since October 1997 when the Michigan United Conservation Clubs and several other organizations and individuals filed the underlying lawsuit. In accordance with the Michigan Supreme Court ruling, revenue of \$29.2 million was transferred to DEQ and the case was closed.

SUPPLEMENTAL FINANCIAL  
STATEMENTS AND FINANCIAL SCHEDULES



## Descriptions of Special Revenue Funds

### COMBINED ENVIRONMENTAL PROTECTION BOND FUND

This Fund, which is administered by the Department of Environmental Quality (DEQ), was established by Act 328, P.A. 1988, to account for the proceeds of \$660 million of general obligation bonds approved by Michigan voters in November 1988. The bonds are authorized for financing environmental protection programs to clean up sites of toxic and other environmental contamination and contribute to a regional Great Lakes Protection Fund; address solid waste problems; treat sewage and other water quality problems; and reuse industrial sites and preserve open space. The Act also specifies that not more than \$425 million of the proceeds of these bonds be available to clean up sites of toxic and other environmental contamination; not more than \$150 million be available for solid waste projects; not more than \$60 million be available to capitalize the State Water Pollution Control Loan Fund; and not more than \$25 million be available to fund Michigan's participation in a regional Great Lakes Protection Fund. Act 380, P.A. 1996, provides that interest earnings and unappropriated or lapsed solid waste project allocations be transferred to the Cleanup and Redevelopment Fund.

Act 284, P.A. 1998, expanded this Fund to account for the proceeds of \$570 million of general obligation bonds approved by Michigan voters in November 1998. Act 288, P.A. 1998, directs that not more than \$335 million can be used for environmental response activities at facilities; not more than \$50 million for waterfront improvements; not more than \$25 million for remediation of contaminated lake and river sediments; not more than \$50 million for nonpoint source pollution prevention and control projects or wellhead protection projects; not more than \$90 million for water quality monitoring and water resources protection and pollution control activities; and not more than \$20 million for pollution prevention programs.

### MICHIGAN UNDERGROUND STORAGE TANK FINANCIAL ASSURANCE (MUSTFA) FUND

The MUSTFA Fund was established by Act 518, P.A. 1988, to assist certain owners and operators of underground storage tank systems in meeting their financial responsibility requirements provided for in the Solid Waste Disposal Act. It is administered by DEQ and an 11-member advisory board.

The primary source of revenues is an environmental protection regulatory fee of 7/8 of a cent per gallon imposed on all refined petroleum products sold for resale. Expenditures are primarily amounts spent to assist in environmental cleanup. Acts 252 and 269, P.A. 1995, limit the MUSTFA Fund's liability for claims to those billings received by June 29, 1995. The State's liability for environmental cleanup claims is further limited by law to the amount of available resources. Liabilities, in excess of available funds, for unpaid work performed on eligible environmental cleanup claims will be paid from future years' revenues and are recorded as a liability in the government-wide financial statements.

#### BOTTLE DEPOSITS FUND

This Fund was created by Act 384, P.A. 1996, to provide for the disposition of unredeemed bottle deposits. The Fund is jointly administered by the Department of Treasury and DEQ. The law mandates that an annual distribution of funds be made as follows: 25% returned to the dealers and 75% to fund several subfunds.

The 75% is initially deposited into the Cleanup and Redevelopment Trust Subfund (CRTF) and, if not further distributed, remains there until the principal amount reaches \$200 million. Additionally, of funds received annually by CRTF, 80% is allocated to the Cleanup and Redevelopment Subfund (CRF) and 10% to the Community Pollution Prevention Subfund.

Act 380, P.A. 1996, moved the former Environmental Response Fund (ERF) to a subfund of CRF. The law mandates that proceeds of all cost recovery actions taken and settlements entered into pursuant to ERF (excluding natural resource damages) by DEQ or the Attorney General, or both, shall be credited to ERF.

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Combining Balance Sheet  
Special Revenue Funds  
As of September 30  
(in thousands)

	Combined Environmental Protection Bond Fund		Michigan Underground Storage Tank Financial Assurance Fund		Bottle Deposits Fund		Totals	
	2001	2000	2001	2000	2001	2000	2001	2000
	(RESTATED)							
<b>ASSETS</b>								
Current Assets:								
Cash	\$	\$	\$	\$	\$ 37	\$	\$ 37	\$ 0
Equity in Common Cash	48,101	64,860	2,078	4,211	151,442	120,602	201,620	189,672
Taxes, interest, and penalties receivable			5,693	5,110			5,693	5,110
Amounts due from local units	720	1,891			566		1,286	1,891
Amounts due from other funds			1,000				1,000	0
Other current assets	34	62	4	2	4,718	4,845	4,755	4,909
Total Current Assets	\$ 48,855	\$ 66,813	\$ 8,775	\$ 9,323	\$ 156,762	\$ 125,446	\$ 214,392	\$ 201,582
Amounts due from local units					4,467	3,785	4,467	3,785
Other noncurrent assets		5			674	957	674	962
Total Assets	\$ 48,855	\$ 66,818	\$ 8,775	\$ 9,323	\$ 161,903	\$ 130,188	\$ 219,533	\$ 206,328
<b>LIABILITIES AND FUND BALANCES</b>								
Current Liabilities:								
Warrants outstanding	\$ 763	\$ 966	\$ 4	\$ 31	\$ 42	\$ 1,610	\$ 809	\$ 2,607
Accounts payable and other liabilities	36,830	27,999	372	704	13,586	9,379	50,788	38,082
Amounts due to other funds	1	1	37	17	13	4	50	21
Deferred revenue					318	336	318	336
Total Current Liabilities	\$ 37,594	\$ 28,967	\$ 413	\$ 751	\$ 13,959	\$ 11,329	\$ 51,966	\$ 41,047
Deferred revenue					674	957	674	957
Total Liabilities	\$ 37,594	\$ 28,967	\$ 413	\$ 751	\$ 14,633	\$ 12,285	\$ 52,640	\$ 42,003
Fund Balances:								
Reserves for:								
Budgetary carry-forwards:								
Encumbrances	\$	\$	\$ 2	\$ 39	\$ 4,324	\$ 4,844	\$ 4,326	\$ 4,883
Restricted revenues			1,953	2,430	113,310	84,043	115,262	86,474
Multi-year projects			41,780	41,925	10,953	14,756	52,732	56,681
Revolving loan programs					5,456	4,944	5,456	4,944
Funds held as permanent investments					13,228	9,315	13,228	9,315
Noncurrent assets		5					0	5
Total Reserved	\$ 0	\$ 5	\$ 43,735	\$ 44,394	\$ 147,270	\$ 117,902	\$ 191,005	\$ 162,301
Unreserved	11,261	37,846	(35,372)	(35,823)			(24,112)	2,023
Total Fund Balances	\$ 11,261	\$ 37,851	\$ 8,363	\$ 8,572	\$ 147,270	\$ 117,902	\$ 166,893	\$ 164,325
Total Liabilities and Fund Balances	\$ 48,855	\$ 66,818	\$ 8,775	\$ 9,323	\$ 161,903	\$ 130,188	\$ 219,533	\$ 206,328

**DEPARTMENT OF ENVIRONMENTAL QUALITY**  
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances  
Special Revenue Funds  
Fiscal Year Ended September 30  
(in thousands)

	Combined Environmental Protection Bond Fund		Michigan Underground Storage Tank Financial Assurance Fund		Bottle Deposits Fund		Totals	
	2001	2000	2001	2000	2001	2000	2001	2000
	<b>REVENUES</b>							
Taxes	\$	\$	\$ 58,495	\$ 59,820	\$	\$	\$ 58,495	\$ 59,820
Interest and other miscellaneous	8,961	4,388	59	293	36,554	34,449	45,575	39,130
<b>Total Revenues</b>	<b>\$ 8,961</b>	<b>\$ 4,388</b>	<b>\$ 58,554</b>	<b>\$ 60,113</b>	<b>\$ 36,554</b>	<b>\$ 34,449</b>	<b>\$ 104,069</b>	<b>\$ 98,950</b>
<b>EXPENDITURES</b>								
Current:								
General government	\$	\$	\$ 477	\$ 727	\$	\$	\$ 477	\$ 727
Health services	1,391	534					1,391	534
Environmental	78,052	50,149	4,126	4,816	23,280	21,085	105,458	76,050
<b>Total Expenditures</b>	<b>\$ 79,444</b>	<b>\$ 50,683</b>	<b>\$ 4,604</b>	<b>\$ 5,543</b>	<b>\$ 23,280</b>	<b>\$ 21,085</b>	<b>\$ 107,327</b>	<b>\$ 77,311</b>
Excess of Revenues Over (Under) Expenditures	\$ (70,483)	\$ (46,295)	\$ 53,951	\$ 54,570	\$ 13,274	\$ 13,364	\$ (3,258)	\$ 21,639
<b>OTHER FINANCING SOURCES (USES)</b>								
Proceeds from bond issues	\$ 60,499	\$ 81,947	\$	\$	\$	\$	\$ 60,499	\$ 81,947
Transfers from other funds			4,000	4,000	16,602	7,031	20,602	11,031
Transfers to other funds	(16,607)	(7,031)	(58,160)	(58,017)	(509)	(392)	(75,276)	(65,440)
<b>Total Other Financing Sources (Uses)</b>	<b>\$ 43,892</b>	<b>\$ 74,917</b>	<b>\$ (54,160)</b>	<b>\$ (54,017)</b>	<b>\$ 16,093</b>	<b>\$ 6,638</b>	<b>\$ 5,826</b>	<b>\$ 27,538</b>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	\$ (26,591)	\$ 28,622	\$ (209)	\$ 553	\$ 29,368	\$ 20,003	\$ 2,568	\$ 49,177
Fund Balances - Beginning of fiscal year	37,851	9,229	8,572	8,019	117,902	97,899	164,325	115,147
Fund Balances - End of fiscal year	<b>\$ 11,261</b>	<b>\$ 37,851</b>	<b>\$ 8,363</b>	<b>\$ 8,572</b>	<b>\$ 147,270</b>	<b>\$ 117,902</b>	<b>\$ 166,893</b>	<b>\$ 164,325</b>

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Balance Sheet  
Combined Environmental Protection Bond Fund  
Fiscal Year Ended September 30  
(in thousands)

	Environmental Protection Bond Fund		Clean Michigan Initiative Bond Fund		Totals	
	2001	2000	2001	2000	2001	2000
<b>ASSETS</b>						
Current Assets:						
Equity in Common Cash	\$ 14,415	\$ 2,392	\$ 33,686	\$ 62,467	\$ 48,101	\$64,860
Amounts due from local units	300	23	420	1,868	720	1,891
Other current assets	26	56	8	6	34	62
Total Current Assets	\$ 14,741	\$ 2,471	\$ 34,114	\$ 64,342	\$ 48,855	\$66,813
Other noncurrent assets		5				5
Total Assets	\$ 14,741	\$ 2,476	\$ 34,114	\$ 64,342	\$ 48,855	\$66,818
<b>LIABILITIES AND FUND BALANCES</b>						
Current Liabilities:						
Warrants outstanding	\$ 425	\$ 706	\$ 338	\$ 260	\$ 763	\$ 966
Accounts payable and other liabilities	11,710	18,180	25,120	9,820	36,830	27,999
Amounts due to other funds			1	1	1	1
Total Current Liabilities	\$ 12,136	\$ 18,886	\$ 25,459	\$ 10,081	\$ 37,594	\$28,967
Total Liabilities	\$ 12,136	\$ 18,886	\$ 25,459	\$ 10,081	\$ 37,594	\$28,967
Fund Balances:						
Reserves for:						
Noncurrent assets	\$	\$ 5	\$	\$	\$	\$ 5
Total Reserved	\$ 0	\$ 5	\$ 0	\$ 0	\$ 0	\$ 5
Unreserved	2,605	(16,415)	8,655	54,261	11,261	37,846
Total Fund Balances	\$ 2,605	\$ (16,410)	\$ 8,655	\$ 54,261	\$ 11,261	\$37,851
Total Liabilities and Fund Balances	\$ 14,741	\$ 2,476	\$ 34,114	\$ 64,342	\$ 48,855	\$66,818

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Statement of Revenues, Expenditures, and Changes in Fund Balances  
Combined Environmental Protection Bond Fund  
Fiscal Year Ended September 30  
(in thousands)

	Environmental Protection Bond Fund		Clean Michigan Initiative Bond Fund		Totals	
	2001	2000	2001	2000	2001	2000
<b>REVENUES</b>						
Interest and other miscellaneous	\$ 3,978	\$ 1,510	\$ 4,982	\$ 2,879	\$ 8,961	\$ 4,388
Total Revenues	<u>\$ 3,978</u>	<u>\$ 1,510</u>	<u>\$ 4,982</u>	<u>\$ 2,879</u>	<u>\$ 8,961</u>	<u>\$ 4,388</u>
<b>EXPENDITURES</b>						
Current:						
Health services	\$	\$	\$ 1,391	\$ 534	\$ 1,391	\$ 534
Environmental	<u>28,860</u>	<u>36,077</u>	<u>49,192</u>	<u>14,072</u>	<u>78,052</u>	<u>50,149</u>
Total Expenditures	<u>\$ 28,860</u>	<u>\$ 36,077</u>	<u>\$ 50,583</u>	<u>\$ 14,606</u>	<u>\$ 79,444</u>	<u>\$ 50,683</u>
Excess of Revenues Over (Under) Expenditures	<u>\$ (24,882)</u>	<u>\$ (34,567)</u>	<u>\$ (45,601)</u>	<u>\$ (11,727)</u>	<u>\$ (70,483)</u>	<u>\$ (46,295)</u>
<b>OTHER FINANCING SOURCES (USES)</b>						
Proceeds from bond issues	\$ 60,499	\$	\$	\$ 81,947	\$ 60,499	\$ 81,947
Transfers to other funds	<u>(16,602)</u>	<u>(7,031)</u>	<u>(5)</u>	<u></u>	<u>(16,607)</u>	<u>(7,031)</u>
Total Other Financing Sources (Uses)	<u>\$ 43,897</u>	<u>\$ (7,031)</u>	<u>\$ (5)</u>	<u>\$ 81,947</u>	<u>\$ 43,892</u>	<u>\$ 74,917</u>
Excess of Revenues and Other Sources Over (Under) Expenditures and Other Uses	\$ 19,015	\$ (41,598)	\$ (45,606)	\$ 70,220	\$ (26,591)	\$ 28,622
Fund Balances - Beginning of fiscal year	<u>(16,410)</u>	<u>25,188</u>	<u>54,261</u>	<u>(15,959)</u>	<u>37,851</u>	<u>9,229</u>
Fund Balances - End of fiscal year	<u>\$ 2,605</u>	<u>\$ (16,410)</u>	<u>\$ 8,655</u>	<u>\$ 54,261</u>	<u>\$ 11,261</u>	<u>\$ 37,851</u>

## Description of Agency Fund

### ENVIRONMENTAL QUALITY DEPOSITS FUND

This Fund was reauthorized by Act 451, P.A. 1994, as amended, to account for cash bonds posted by applicants desiring licenses to operate hazardous and solid waste disposal areas. Because the Scrap Tire Regulatory Fund created by Act 451, P.A. 1994, has similar provisions, both of these activities are accounted for in this Fund. In accordance with Act 451, P.A. 1994, as amended, interest earnings up to an annual rate of 6% are credited to the applicant's account. This Act also specifies the circumstances under which the director of the Department of Environmental Quality is authorized to use the deposits to close and maintain a facility or return the deposit upon the operator's satisfactory closure and maintenance of the facility.

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Statement of Changes in Assets and Liabilities  
Environmental Quality Deposits Fund  
Fiscal Year Ended September 30, 2001  
(in thousands)

	<u>Balance October 1, 2000</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance September 30, 2001</u>
<b>ASSETS</b>				
Current Assets:				
Equity in Common Cash	<u>\$ 2,440</u>	<u>\$ 1,469</u>	<u>\$ 502</u>	<u>\$ 3,407</u>
Total Assets	<u><u>\$ 2,440</u></u>	<u><u>\$ 1,469</u></u>	<u><u>\$ 502</u></u>	<u><u>\$ 3,407</u></u>
<b>LIABILITIES</b>				
Current Liabilities:				
Accounts payable and other liabilities	<u>\$ 2,440</u>	<u>\$ 1,469</u>	<u>\$ 502</u>	<u>\$ 3,407</u>
Total Liabilities	<u><u>\$ 2,440</u></u>	<u><u>\$ 1,469</u></u>	<u><u>\$ 502</u></u>	<u><u>\$ 3,407</u></u>



DEPARTMENT OF ENVIRONMENTAL QUALITY  
Statement of Changes in Assets and Liabilities  
Environmental Quality Deposits Fund  
Fiscal Year Ended September 30, 2000  
(in thousands)

	<u>Balance</u> <u>October 1,</u> <u>1999</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>September 30,</u> <u>2000</u>
<b>ASSETS</b>				
Current Assets:				
Equity in Common Cash	<u>\$ 3,371</u>	<u>\$ 501</u>	<u>\$ 1,432</u>	<u>\$ 2,440</u>
Total Assets	<u>\$ 3,371</u>	<u>\$ 501</u>	<u>\$ 1,432</u>	<u>\$ 2,440</u>
<b>LIABILITIES</b>				
Current Liabilities:				
Accounts payable and other liabilities	<u>\$ 3,371</u>	<u>\$ 500</u>	<u>\$ 1,431</u>	<u>\$ 2,440</u>
Total Liabilities	<u>\$ 3,371</u>	<u>\$ 500</u>	<u>\$ 1,431</u>	<u>\$ 2,440</u>

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DEPARTMENT OF ENVIRONMENTAL QUALITY  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 1999 through September 30, 2000

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2000		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Financial Assistance					
<b>U.S. Department of Commerce</b>					
Direct Program:					
Coastal Zone Management Administration Awards	11.419		\$ 1,390,876	\$ 998,325	\$ 2,389,201
<b>Total U.S. Department of Commerce</b>			<b>\$ 1,390,876</b>	<b>\$ 998,325</b>	<b>\$ 2,389,201</b>
<b>U.S. Department of Defense</b>					
Direct Program:					
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		\$ 324,073	\$	\$ 324,073
<b>Total U.S. Department of Defense</b>			<b>\$ 324,073</b>	<b>\$ 0</b>	<b>\$ 324,073</b>
<b>U.S. Department of the Interior</b>					
Direct Programs:					
Wildlife Conservation and Appreciation	15.617		\$ 18,727	\$ 41,088	\$ 59,815
U.S. Geological Survey - Research and Data Acquisition	15.808		20,850		20,850
National Cooperative Geologic Mapping Program	15.810		12,481	39,593	52,074
<b>Total U.S. Department of the Interior</b>			<b>\$ 52,058</b>	<b>\$ 80,681</b>	<b>\$ 132,739</b>
<b>U.S. Environmental Protection Agency</b>					
Direct Programs:					
Air Pollution Control Program Support	66.001		\$ 2,562,117	\$	\$ 2,562,117
State Indoor Radon Grants	66.032		198,392	104,820	303,212
Water Pollution Control - State and Interstate Program Support	66.419		4,090,046		4,090,046
State Public Water System Supervision	66.432		4,005,196		4,005,196
Water Quality Management Planning	66.454		263,877	244,546	508,423
Capitalization Grants for State Revolving Funds	66.458		1,641,409	92,341,003	93,982,412
Nonpoint Source Implementation Grants	66.460		999,466	2,836,328	3,835,794
Wetlands Grants	66.461		203,250	175,177	378,427
Water Quality Cooperative Agreements	66.463		473,351	72,161	545,512
Wastewater Operator Training Grant Program	66.467		49,000		49,000
Capitalization Grants for Drinking Water State Revolving Fund	66.468		1,912,059	45,131,498	47,043,557
Great Lakes Program	66.469		68,526	200,056	268,582
Surveys, Studies, Investigations, and Special Purpose Grants	66.606		1,120,586	149,023	1,269,609
One Stop Reporting	66.608				
Pollution Prevention Grants Program	66.708		140,403		140,403
Hazardous Waste Management State Program Support	66.801		3,675,361	4,586	3,679,947
Superfund State Site - Specific Cooperative Agreements	66.802		4,057,010		4,057,010
State and Tribal Underground Storage Tanks Program	66.804		186,000		186,000
Leaking Underground Storage Tank Trust Fund Program	66.805		1,989,653		1,989,653
Superfund State Core Program Cooperative Agreements	66.809		1,174,522		1,174,522
<b>Total Direct Programs</b>			<b>\$ 28,810,224</b>	<b>\$ 141,259,198</b>	<b>\$ 170,069,422</b>
Pass-Through Programs:					
Great Lakes Commission Great Lakes Program	66.469	A995353-02	\$ 68,875	\$	\$ 68,875

This schedule continued on next page.

<u>For the Fiscal Year Ended September 30, 2001</u>			
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	<u>Total Expended and Distributed for the Two-Year Period</u>
\$ 1,462,448	\$ 1,034,754	\$ 2,497,202	\$ 4,886,403
<b>\$ 1,462,448</b>	<b>\$ 1,034,754</b>	<b>\$ 2,497,202</b>	<b>\$ 4,886,403</b>
\$ 341,227	\$	\$ 341,227	\$ 665,300
<b>\$ 341,227</b>	<b>\$ 0</b>	<b>\$ 341,227</b>	<b>\$ 665,300</b>
\$ 49,618	\$ 17,887	\$ 67,505	\$ 127,320
48,364		48,364	69,214
	79,154	79,154	131,228
<b>\$ 97,982</b>	<b>\$ 97,041</b>	<b>\$ 195,023</b>	<b>\$ 327,762</b>
\$ 2,323,614	\$	\$ 2,323,614	\$ 4,885,731
232,963	106,130	339,093	642,305
5,499,331		5,499,331	9,589,377
4,077,436		4,077,436	8,082,632
271,216	265,577	536,793	1,045,216
1,499,597	51,679,043	53,178,640	147,161,052
972,732	3,630,791	4,603,523	8,439,317
114,578	71,464	186,042	564,469
551,973	5,248	557,221	1,102,733
47,700		47,700	96,700
2,601,095	21,526,369	24,127,464	71,171,021
184,134		184,134	452,716
781,156	170,907	952,063	2,221,672
140,136		140,136	140,136
63,974		63,974	204,377
3,803,355		3,803,355	7,483,302
3,792,760		3,792,760	7,849,770
223,125		223,125	409,125
2,017,452		2,017,452	4,007,105
1,076,099		1,076,099	2,250,621
<b>\$ 30,274,426</b>	<b>\$ 77,455,529</b>	<b>\$ 107,729,955</b>	<b>\$ 277,799,377</b>
\$ 95,777	\$	\$ 95,777	\$ 164,652

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Schedule of Expenditures of Federal Awards (1)  
For the Period October 1, 1999 through September 30, 2000  
Continued

Federal Agency/Program	CFDA (2) Number	Pass-Through Identification Number	For the Fiscal Year Ended September 30, 2000		
			Directly Expended	Distributed to Subrecipients	Total Expended and Distributed
Wayne County					
Surveys, Studies, Investigations, and Special Purpose Grants	66.606	XP995743-02	\$ 49,028	\$	\$ 49,028
Surveys, Studies, Investigations, and Special Purpose Grants	66.606	XP995743-04	19,708		19,708
Inter-Tribal					
Surveys, Studies, Investigations, and Special Purpose Grants	66.606	PM975229-01			0
University of Illinois					
Pollution Prevention Grants Program	66.708	NP985602-01-2	10,000		10,000
Total Pass-Through Programs			<u>\$ 147,611</u>	<u>\$ 0</u>	<u>\$ 147,611</u>
<b>Total U.S. Environmental Protection Agency</b>			<b><u>\$ 28,957,835</u></b>	<b><u>\$ 141,259,198</u></b>	<b><u>\$ 170,217,033</u></b>
<b>Federal Emergency Management Agency</b>					
Direct Program:					
National Dam Safety Program	83.550		<u>\$ 32,436</u>	<u>\$</u>	<u>\$ 32,436</u>
Pass-Through Programs:					
Michigan Department of State Police					
Community Assistance Program - State Support Services Element	83.105	EMC-2000-GR-0012	\$ 164,000	\$	\$ 164,000
Community Assistance Program - State Support Services Element	83.105	EMC-2001-GR-0011			0
Flood Mitigation Assistance	83.536	EMC-98-PA-1337	4,007		4,007
Hazard Mitigation Grant	83.548	FEMA-1881-DR	28,420		28,420
Hazard Mitigation Grant	83.548	FEMA-1226-DR	51,523		51,523
Emergency Management Performance Grants	83.552	EMC-2001-GR-0003	13,617		13,617
Total Pass-Through Programs			<u>\$ 261,567</u>	<u>\$ 0</u>	<u>\$ 261,567</u>
<b>Total Federal Emergency Management Agency</b>			<b><u>\$ 294,003</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 294,003</u></b>
Total Financial Assistance			<u>\$ 31,018,845</u>	<u>\$ 142,338,204</u>	<u>\$ 173,357,049</u>
<u>Nonfinancial Assistance</u>					
<b>U.S. Environmental Protection Agency</b>					
Direct Programs:					
Water Pollution Control - State and Interstate Program Support	66.419		\$	\$	\$
Surveys, Studies, Investigations, and Special Purpose Grants	66.606				
<b>Total U.S. Environmental Protection Agency</b>			<b><u>\$ 0</u></b>	<b><u>\$ 0</u></b>	<b><u>\$ 0</u></b>
Total Nonfinancial Assistance			<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Total Expenditures of Federal Awards			<u>\$ 31,018,845</u>	<u>\$ 142,338,204</u>	<u>\$ 173,357,049</u>

(1) Basis of Presentation: This schedule includes the federal grant activity of the Department of Environmental Quality and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements and financial schedules.

(2) CFDA is defined as *Catalog of Federal Domestic Assistance*.

<u>For the Fiscal Year Ended September 30, 2001</u>			
<u>Directly Expended</u>	<u>Distributed to Subrecipients</u>	<u>Total Expended and Distributed</u>	<u>Total Expended and Distributed for the Two-Year Period</u>
\$ 91,693	\$ 1,455	\$ 93,148	\$ 142,176
97,191		97,191	116,899
13,879		13,879	13,879
		0	10,000
<u>\$ 298,540</u>	<u>\$ 1,455</u>	<u>\$ 299,995</u>	<u>\$ 447,606</u>
<u>\$ 30,572,966</u>	<u>\$ 77,456,984</u>	<u>\$ 108,029,950</u>	<u>\$ 278,246,983</u>
<u>\$ 51,427</u>	<u>\$</u>	<u>\$ 51,427</u>	<u>\$ 83,863</u>
\$	\$	\$ 0	\$ 164,000
164,000		164,000	164,000
1,580		0	4,007
45,972		1,580	30,000
21,075		45,972	97,495
		21,075	34,692
<u>\$ 232,627</u>	<u>\$ 0</u>	<u>\$ 232,627</u>	<u>\$ 494,194</u>
<u>\$ 284,054</u>	<u>\$ 0</u>	<u>\$ 284,054</u>	<u>\$ 578,057</u>
<u>\$ 32,758,677</u>	<u>\$ 78,588,779</u>	<u>\$ 111,347,456</u>	<u>\$ 284,704,505</u>
\$ 47,576	\$	\$ 47,576	\$ 47,576
<u>542,678</u>	<u></u>	<u>542,678</u>	<u>542,678</u>
<u>\$ 590,254</u>	<u>\$ 0</u>	<u>\$ 590,254</u>	<u>\$ 590,254</u>
<u>\$ 590,254</u>	<u>\$ 0</u>	<u>\$ 590,254</u>	<u>\$ 590,254</u>
<u>\$ 33,348,931</u>	<u>\$ 78,588,779</u>	<u>\$ 111,937,710</u>	<u>\$ 285,294,759</u>

INDEPENDENT AUDITOR'S REPORTS ON  
COMPLIANCE AND INTERNAL CONTROL



STATE OF MICHIGAN  
OFFICE OF THE AUDITOR GENERAL  
201 N. WASHINGTON SQUARE  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

## Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

April 24, 2002

Mr. Russell J. Harding, Director  
Department of Environmental Quality  
Constitution Hall  
Lansing, Michigan

Dear Mr. Harding:

We have audited the financial statements and financial schedules of the Department of Environmental Quality as of and for the fiscal years ended September 30, 2001 and September 30, 2000 and have issued our reports thereon dated April 24, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

### Compliance

As part of obtaining reasonable assurance about whether the Department's financial statements and financial schedules are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement and schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and financial schedules and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A



material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL



STATE OF MICHIGAN  
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THOMAS H. MCTAVISH, C.P.A.  
AUDITOR GENERAL

Independent Auditor's Report on Compliance With  
Requirements Applicable to Each Major Program  
and on Internal Control Over Compliance in  
Accordance With OMB Circular A-133

April 24, 2002

Mr. Russell J. Harding, Director  
Department of Environmental Quality  
Constitution Hall  
Lansing, Michigan

Dear Mr. Harding:

Compliance

We have audited the compliance of the Department of Environmental Quality with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000. The Department's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Department's management. Our responsibility is to express an opinion on the Department's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the previous paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Department's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Department's compliance with those requirements.

As described in Finding 1 in the accompanying schedule of findings and questioned costs, the Department did not comply with requirements regarding subrecipient monitoring that are applicable to its Capitalization Grants for State Revolving Funds and Capitalization Grants for Drinking Water State Revolving Fund. Compliance with such requirements is necessary, in our opinion, for the Department to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the previous paragraph, the Department of Environmental Quality complied, in all material respects, with the requirements referred to in the third previous paragraph that are applicable to each major federal program for the fiscal years ended September 30, 2001 and September 30, 2000.

#### Internal Control Over Compliance

The management of the Department is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Department's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the State's management, the Legislature, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

# SCHEDULE OF FINDINGS AND QUESTIONED COSTS\*

## Section I: Summary of Auditor's Results

### Financial Statements and Financial Schedules

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	No
Reportable conditions* identified that are not considered to be material weaknesses?	None reported
Noncompliance material to the financial statements and financial schedules?	No

### Federal Awards

Internal control over major programs:	
Material weaknesses identified?	No
Reportable conditions identified that are not considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major programs: Unqualified for all major programs except for Capitalization Grants for State Revolving Funds and Capitalization Grants for Drinking Water State Revolving Fund, which are qualified*.	
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	Yes

\* See glossary at end of report for definition.

Identification of major programs:

<i>CFDA</i> Number	Name of Federal Program
11.419	Coastal Zone Management Administration Awards
66.001	Air Pollution Control Program Support
66.419	Water Pollution Control - State and Interstate Program Support
66.432	State Public Water System Supervision
66.458	Capitalization Grants for State Revolving Funds
66.460	Nonpoint Source Implementation Grants
66.468	Capitalization Grants for Drinking Water State Revolving Fund
66.801	Hazardous Waste Management State Program Support
66.802	Superfund State Site - Specific Cooperative Agreements

Dollar threshold used to distinguish between type A and type B programs:      \$3,000,000

Auditee qualified as a low-risk auditee\*?      No

\* See glossary at end of report for definition.

## Section II: Findings Related to the Financial Statements and Financial Schedules

We did not report any findings related to the financial statements and financial schedules.

The status of the findings related to the financial statements and financial schedules that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.

## Section III: Findings and Questioned Costs Related to Federal Awards

### **FINDING 760201**

#### 1. State Revolving Fund\* (SRF) Program\* Subrecipient\* Designation

U.S. Environmental Protection Agency	CFDA: 66.458 Capitalization Grants for State Revolving Funds
Award Numbers: CS260001-98 CS260001-99 CS260001-00 CS260001-01	Award Period: 08/01/98 - 12/31/00 05/01/99 - 09/01/01 06/05/00 - 09/30/01 10/01/00 - 09/30/02
	Questioned Costs: \$0

U.S. Environmental Protection Agency	CFDA: 66.468 Capitalization Grants for Drinking Water State Revolving Fund
Award Numbers: FS985747-01 FS995500-01 FS975487-01 FS975244-00	Award Period: 10/01/97 - 05/31/02 04/01/99 - 12/01/01 10/01/00 - 09/30/02 03/08/00 - 03/07/02
	Questioned Costs: \$0

\* See glossary at end of report for definition.

SRF Program subrecipient municipalities either did not submit Single Audit reports or submitted reports that did not identify disbursements received from SRF and the Drinking Water State Revolving Fund\* (DWSRF) as federal financial assistance on their schedules of expenditures of federal awards. This indicates that the municipalities' use of SRF Program money was not subject to audit testing for compliance with applicable federal program laws and regulations.

The Department of Environmental Quality (DEQ) and the Michigan Municipal Bond Authority, Department of Treasury, administer the SRF Program and the DWSRF Program\*, with DEQ as the direct recipient of the federal Capitalization Grants for State Revolving Funds (CFDA #66.458) and the Capitalization Grants for Drinking Water State Revolving Fund (CFDA #66.468). Subrecipient project eligibility and loan terms are determined by DEQ. Loan processing and actual distribution of funds to subrecipient municipalities from SRF and DWSRF are directed by the Michigan Municipal Bond Authority. The sources of funds within SRF and DWSRF from which municipalities draw assistance include federal SRF and DWSRF capitalization grants, repayments of prior loan principal and interest, leveraged bond funds, State match funds, and SRF and DWSRF earnings.

Our review of 43 SRF and DWSRF loans, which met the Single Audit threshold, to 40 municipalities disclosed that 21 municipalities did not submit Single Audit reports. Also, 13 Single Audit reports did not identify disbursements received from SRF and DWSRF as federal assistance on their schedules of expenditures of federal awards.

The U.S. Environmental Protection Agency's (EPA's) SRF and DWSRF Program Guidance states that the direct recipient of the federal assistance (i.e., DEQ) must ensure that the SRF and DWSRF Program subrecipients comply with the provisions of the Single Audit Act. Also, this guidance states that funds directly made available to the municipalities from the SRF and DWSRF capitalization grants should be considered federal funds subject to the terms of the Single Audit Act. Further, Title 40, Part 31, section 37 of the *Code of Federal Regulations* requires DEQ to ensure that its subrecipients are aware of requirements imposed upon them by federal statute and regulations. In addition, the Single Audit Act requires DEQ to provide subrecipients with the federal program name and

\* See glossary at end of report for definition.

identifying numbers in addition to the federal requirements that govern the use of awards.

Without Single Audit reports and clear identification to SRF and DWSRF Program subrecipient municipalities that SRF and DWSRF loans are federal financial assistance, DEQ does not have assurance that the municipalities are complying with all federal regulations applicable to the SRF and DWSRF Programs. Although the receipt of audit reports does not by itself constitute effective subrecipient monitoring, the reports identify internal control weaknesses and instances of noncompliance with laws and regulations that need additional follow-up by DEQ. DEQ reported distributions to subrecipients of \$92.3 million and \$51.7 million in fiscal years 1999-2000 and 2000-01, respectively, for Capitalization Grants for State Revolving Funds on its schedule of expenditures of federal awards. DEQ also reported distributions to subrecipients of \$45.1 million and \$21.5 million in fiscal years 1999-2000 and 2000-01, respectively, for Capitalization Grants for Drinking Water State Revolving Fund on its schedule of expenditures of federal awards.

In response to a similar prior audit finding, DEQ disagreed with our finding and stated: ". . . No federal grant funds go directly to loan recipients, thus the requirements of U.S. Office of Management and Budget Circular A-133 do not apply." During our audit, the EPA refuted DEQ's audit response as follows:

However, this is inconsistent with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, which defines a Federal award as 'Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies **or indirectly from pass-through entities.**'

Also, the EPA issued a separate memorandum clarifying the Single Audit Act requirements as they apply to SRF Program assistance recipients. The EPA stated that for SRF and DWSRF ". . . an amount equal to funds 'directly made available by' the capitalization grant are considered Federal funds or Federal financial assistance. These funds are subject to SAA [Single Audit Act] requirements." Further, the EPA stated the need to include this Single Audit Act requirement in the terms of the financial assistance stated in a State's SRF Intended Use Plan.



For fiscal year 2001-02, DEQ has committed to specific actions, which the EPA has considered appropriate resolution of our prior audit finding.

**RECOMMENDATION**

WE AGAIN RECOMMEND THAT DEQ ENSURE THAT SRF PROGRAM SUBRECIPIENT MUNICIPALITIES ARE AWARE THAT SRF LOANS ARE FEDERAL FINANCIAL ASSISTANCE AND ARE SUBMITTING SINGLE AUDIT REPORTS IDENTIFYING DISBURSEMENTS RECEIVED FROM SRF AS FEDERAL FINANCIAL ASSISTANCE ON THEIR SCHEDULES OF EXPENDITURES OF FEDERAL AWARDS.

**The status of the findings related to federal awards that were reported in prior Single Audits is disclosed in the summary schedule of prior audit findings.**

# OTHER SCHEDULES

DEPARTMENT OF ENVIRONMENTAL QUALITY  
Summary Schedule of Prior Audit Findings  
As of September 30, 2001

**PRIOR AUDIT FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES**

Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 1997 through September 30, 1999

**Finding Number:** 760001

**Finding:** The Department of Environmental Quality (DEQ) had not developed and implemented effective internal control for personnel and payroll functions. Management controls are critical to help prevent and detect, on a timely basis, the processing of erroneous and unauthorized transactions.

The review of personnel and payroll functions disclosed the following internal control weaknesses:

- a. DEQ did not consistently prepare and reconcile daily transaction control logs of transactions entered into the Personnel-Payroll Information System for Michigan (PPRISM).
- b. DEQ did not separate payroll duties between the transaction operators and the agency master operator.
- c. DEQ's internal control did not detect transaction operators who entered their own PPRISM transactions or prevent them from doing so.
- d. DEQ did not reconcile the PPRISM biweekly transaction reports (PE-110 reports) with source documents.

**Comments:** (a) The Office of Personnel Services did establish and implement internal control for personnel and payroll functions as a result of the previous Single Audit. The transactions

staff supervisor at that time followed these procedures. When this person was replaced in May 1999, the expectation to follow these procedures was not communicated to the new transactions staff supervisor. Therefore, only portions of the monitoring process were being performed. When this lack of control was brought to the attention of the Office of Personnel Services, the more thorough review was reinstated (April 1, 2000). To ensure that this process continues, follow-up will take place quarterly to ensure that the daily transaction control monitoring is being conducted.

- (b) DEQ agrees that transaction operators have been given access to the PSWU\* code. They only use it to give passwords to those operators who are already in the system and at a level below their security. Only the department master operator establishes new users or inactivates existing users in the system. The department master operator uses the PPRISM valid operators report (CR-185) to monitor new users and to verify the deletion of users. This was consistently done throughout the audit period. The daily control log, which was not utilized for a period of time as discussed in item (a), provides information about code usage and passwords. From a security perspective, the monitoring of the PPRISM valid operators reports is more critical because the reports identify new users. Although less critical for this function, DEQ has re-instituted use of the daily control log as indicated in item (a).
- (c) The Office of Personnel Services has established the necessary process to monitor PPRISM input by using the daily control log that is completed and reconciled daily against the CNTL\* transaction in PPRISM (re-instituted April 1, 2000). In addition, a written directive was issued

\* See glossary at end of report for definition.

August 16, 2000 to all staff instructing them on the proper procedure to process transactions that are of a personal effect.

- (d) The biweekly reconciliation recommended would be redundant with the daily reconciliation discussed in item (a). DEQ agrees with conducting the daily reconciliation, but does not feel that the redundant biweekly reconciliations are warranted. Existing resources allow for one level of reconciliation to be completed and DEQ feels that daily reconciliations offer the greatest opportunity to detect and correct errors.

**Audit Period:** October 1, 1997 through September 30, 1999

**Finding Number:** 760002

**Finding:** The Drinking Water and Radiological Protection Division did not develop a method for estimating fiscal year-end accounts payable. As a result, expenditures and accounts payable in the Combined Environmental Protection Bond Fund and the Bottle Deposits Fund were misstated.

**Comments:** Providing alternate drinking water supplies at sites of groundwater contamination involves contractual arrangements that frequently span more than one fiscal year. It is often difficult for grantees to obtain reasonable estimates from vendors in order to establish accounts payable. Given the multi-year nature of these work projects, the contracts are encumbered when issued and charged to the appropriate appropriation year. DEQ has worked with grantees to estimate accounts payable where necessary and separate requests for reimbursement by fiscal year. Despite the best efforts of staff, vendors are occasionally unable to provide reasonable estimates or to submit invoices for work prior to the mid-November cut-off for processing payments as old-year expenditures. Any requests for payment of old-year expenditures in the new year must be approved by the Department of Management and Budget and DEQ ensures that this procedure is followed. Contractual language specifically requires submittal of a financial status report at year-end closing.

## PRIOR AUDIT FINDINGS RELATED TO FEDERAL AWARDS

### Audit Findings That Have Been Fully Corrected:

**Audit Period:** October 1, 1997 through September 30, 1999  
**Finding Number:** 760003  
**Finding:** The State Revolving Fund (SRF) Program subrecipient municipalities either did not submit Single Audit reports or submitted reports that did not identify disbursements received from SRF as federal financial assistance on their schedules of expenditures of federal awards. This indicates that the municipalities' use of SRF money was not subject to audit testing for compliance with applicable federal program laws and regulations.  
**Comments:** The prior audit report states (referring to the U.S. Environmental Protection Agency's [EPA's] Program Guidance):

Also, this guidance states that funds directly [emphasis added] made available to the municipalities from the SRF and DWSRF [Drinking Water State Revolving Fund] Capitalization Grants should be considered federal funds subject to the terms of the Single Audit Act.

As previously stated, Michigan utilizes a leveraged bond program, in essence purchasing local debt. No federal grant funds go directly to loan recipients, thus this requirement of U.S. Office of Management and Budget (OMB) Circular A-133 would not appear to apply. This is consistent with the financial advice that we have received from the Michigan Municipal Bond Authority, which was based on a January 12, 2000 letter from Plante & Moran, LLP, to the Authority.

Michigan will continue to work with other states and the EPA to obtain a formal ruling specifically addressing leveraged bond programs, such as Michigan's.

All SRF and DWSRF applicants to date have signed loan applications that contain a covenant indicating that an annual

audit will be conducted consistent with the requirements of the Single Audit Act and OMB Circular A-133. In addition, all loans rendered from program inception through September 1999 contain a general covenant in the Supplemental Agreement requiring recipients to conduct an annual audit and submit a copy of that audit to the Michigan Department of Treasury and the Michigan Municipal Bond Authority. During fiscal years 1999-2000 and 2000-01, in recognition that Michigan had begun using a leveraged bond program, this condition was not included. In response to the Single Audit finding, and given the degree of uncertainty on this matter, the condition was reinstated in fiscal year 2001-02.

In addition, DEQ has placed on its SRF/DWSRF web site and in its quarterly newsletter a discussion of this issue and an advisory that loan recipients should review this matter with their auditors.

<b>Audit Period:</b>	October 1, 1997 through September 30, 1999
<b>Finding Number:</b>	760004
<b>Finding:</b>	DEQ had not established a system to properly allocate payroll expenditures to all federal grant programs.
<b>Comments:</b>	<ol style="list-style-type: none"><li>a. During fiscal year 1999-2000, corrective action has been completed with the implementation of actual activity reporting on the Data Collection and Distribution System (DCDS).</li><li>b. Beginning in fiscal year 1999-2000, a departmentwide method of allocating appropriate administrative support staff time to federal grants was implemented. The percentage of hours that nonadministrative (program) staff charge to federal grants is tracked, and this percentage is used as the basis for charging administrative staff time to federal grants. Program staff record actual hours worked on projects in the payroll system and in accordance with OMB Circular A-87. Administrative staff allocations are budgeted for purposes of the payroll, then reconciled quarterly to be consistent with the percentage of actual time charged by program staff to the federal grants.</li></ol>

DEPARTMENT OF ENVIRONMENTAL QUALITY

Corrective Action Plan

As of June 10, 2002

**FINDINGS RELATED TO THE FINANCIAL STATEMENTS AND FINANCIAL SCHEDULES**

There were no findings related to the financial statements and financial schedules for fiscal years 1999-2000 and 2000-01.

**FINDINGS RELATED TO FEDERAL AWARDS**

**Finding Number:** 760201

**Finding Title:** State Revolving Fund (SRF) Program Subrecipient Designation

In response to a similar finding regarding subrecipient monitoring in a prior Single Audit, the Department of Environmental Quality (DEQ) implemented, as recognized in the finding, specific actions in fiscal year 2001-02 to ensure that recipients are aware that SRF/DWSRF (Drinking Water State Revolving Fund) disbursements are federal financial assistance. These actions were considered adequate by the U.S. Environmental Protection Agency.

DEQ will continue to implement these actions and work with the Michigan Municipal Bond Authority to take necessary additional steps to ensure compliance with the requirements of the Single Audit Act. Any changes to the administration of the SRF and DWSRF Programs to further address this finding will be included in a revision to the Interagency Agreement between DEQ and the Authority.

**Responsible Individual:** Paul Zugger, Chief, Environmental Assistance Division  
Clifford Heckathorn, Chief, Municipal Facilities Section



## Glossary of Acronyms and Terms

CFDA	<i>Catalog of Federal Domestic Assistance.</i>
CNTL	A transaction code that provides three sections of daily operator statistics and update transaction activity: entry transaction count, transaction updates by other agencies, and batch input error list.
CRF	Cleanup and Redevelopment Subfund.
CRTF	Cleanup and Redevelopment Trust Subfund.
DEQ	Department of Environmental Quality.
Drinking Water State Revolving Fund (DWSRF)	A fund established within the Michigan Municipal Bond Authority to provide loans and other types of financial assistance to eligible public water systems.
DWSRF Program	The federal grant program that provides capitalization grants to states for establishing revolving funds to be used for the construction of drinking water systems in compliance with the Safe Drinking Water Act.
EPA	U.S. Environmental Protection Agency.
ERF	Environmental Response Fund.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are fairly presented in conformity with the disclosed basis of accounting.
GASB	Governmental Accounting Standards Board.

<b>internal control</b>	A process, effected by management, designed to provide reasonable assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
<b>low-risk auditee</b>	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
<b>material misstatement</b>	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the results of operations or cash flows in conformity with the disclosed basis of accounting.
<b>material noncompliance</b>	Violations of laws and regulations that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
<b>material weakness</b>	A reportable condition related to the design or operation of internal control that does not reduce to a relatively low level the risk that either misstatements caused by error or fraud in amounts that would be material in relation to the financial schedules and/or financial statements or noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
<b>MUSTFA</b>	Michigan Underground Storage Tank Financial Assurance.
<b>OMB</b>	U.S. Office of Management and Budget.

PPRISM	Personnel-Payroll Information System for Michigan.
PSWU	A transaction code to change, delete, and update passwords for PPRISM users.
qualified opinion	<p data-bbox="565 396 1135 432">An auditor's opinion in which the auditor:</p> <ul style="list-style-type: none"> <li data-bbox="565 510 1443 1226">a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules presenting supplemental financial information in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or</li> <li data-bbox="565 1283 1443 1778">b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves.</li> </ul>

**questioned costs**

A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

**reportable condition**

A matter coming to the auditor's attention relating to a deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the entity's ability to (1) record, process, summarize, and report financial data consistent with the assertions of management in the financial schedules and/or financial statements or (2) administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants.

**Single Audit**

A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.

**SOMCAFR**

*State of Michigan Comprehensive Annual Financial Report.*

SRF Program	The federal grant program that provides capitalization grants to states for establishing revolving funds to be used for the construction of municipal wastewater treatment projects or for the development and implementation of nonpoint source or estuary conservation management programs and plans in compliance with the Clean Water Act.
State Revolving Fund (SRF)	A fund established within the Michigan Municipal Bond Authority to provide low-interest loans to municipalities for the construction of publicly owned water pollution control facilities.
subrecipient	A nonfederal entity that expends federal awards received from another nonfederal entity to carry out a federal program.
unqualified opinion	<p>An auditor's opinion in which the auditor states that:</p> <ul style="list-style-type: none"> <li>a. The financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting; or</li> <li>b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules taken by themselves; or</li> <li>c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.</li> </ul>